

LEGISLATIVE AUDIT COMMISSION



Review of
Illinois Finance Authority
Year Ended June 30, 2006

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ILLINOIS FINANCE AUTHORITY
YEAR ENDED JUNE 30, 2006

FINDINGS/RECOMMENDATIONS - 7
PARTIALLY ACCEPTED - 1
IMPLEMENTED - 6

REPEATED RECOMMENDATIONS - 2

PRIOR AUDIT FINDINGS/RECOMMENDATIONS - 9

This review summarizes the auditors' reports of the Illinois Finance Authority for the year ended June 30, 2006, filed with the Legislative Audit Commission on May 8, 2007. The auditors performed a financial audit and compliance examination in accordance with State law and *Government Auditing Standards*. The auditors stated that the financial statements of the Illinois Development Finance Authority were fairly presented.

The Illinois Finance Authority was created by PA 93-205 which became effective January 1, 2004. The Public Act consolidated seven of the State's existing finance authorities—Illinois Health Facilities Authority, the Illinois Educational Facilities Authority, the Illinois Development Finance Authority, the Illinois Rural Bond Bank, the Illinois Farm Development Authority, the Illinois Community Development Finance Corporation, and the Research Park Authority—creating the Illinois Finance Authority. The activities of each of the bonding authorities were transferred to the IFA. The mission of the Authority is to foster economic development to the public and private institutions that create and retain jobs, and improve the quality of life in Illinois by providing access to capital.

The Authority is governed by a 15-member board of directors, appointed by the Governor with the advice and consent of the Senate. As specified in the law, the amount of outstanding bonds issued by the Authority cannot exceed \$26.65 billion.

Some of the Authority's objectives are to:

- Retain jobs in Illinois by assisting existing businesses considering relocation or plant expansion in obtaining low cost financing;
- Assist in the creation of new jobs by assisting new emerging or expanding businesses in securing project financing, utilizing three direct loan programs and three industrial revenue bond programs;
- Assist municipalities in financing road, water and sewer projects necessary for economic development;
- Induce enterprises to remain, expand, and locate in Illinois by helping to provide seed and investment capital;
- Facilitate employee acquisition of individual and manufacturing facilities about to close or relocate outside Illinois;

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- Provide zero-interest loans to municipalities for rehabilitation and improvement of affordable multi-unit housing for low and moderate-income residents;
- Improve economic conditions of severely depressed municipalities by making grants to support housing, industrial, and commercial projects;
- Expand programs to monitor State bonding activity, initiate favorable legislation at the State and federal level, and communicate information to help inform the public;
- Devote resources to help not-for-profit organizations address housing and service needs of the mentally ill and disabled;
- Assist in providing low cost capital to for-profit and not-for-profit organizations for the financing of day care facilities;
- Work with the Legislature, the Governor and other agencies to develop an integrated plan for waste management and to develop a funding mechanism to assist communities in financing of day care facilities; and
- Assist women, low income and minority entrepreneurs, business owners and other such individuals possessing the capability to operate successful business concerns and assist small business concerns in those areas suffering from lack of credit due to economic downturn.

The Interim Executive Director of the Illinois Finance Authority during the audit period was Jill Rendleman. Ms. Rendleman became the Interim Executive Director in March 2005. She resigned in May 2007 and Ms. Kym Hubbard became the new Executive Director on May 21, 2007. She had no previous association with the Finance Authority.

The average number of employees was 26 at June 30, 2006, down from 29 at June 30, 2005. The predecessor Authorities has 40 employees. The IFA has offices located in Chicago, Carbondale, Mt. Vernon, Peoria, and Springfield.

Financial Information

The Illinois Finance Authority was created on January 1, 2004 following the consolidation of seven existing State authorities into this new organization. The predecessor authorities contributed \$72,585,451 in capital to the newly established Authority.

The Authority has several proprietary funds. The following is a description of the major and some of the non-major funds:

- General Operating Fund—This fund receives all revenues from program applications. All administrative expenses for establishing and monitoring the Authority's programs are paid out of this fund.
- Bond Fund—The purpose of the fund is to collect bond proceeds, purchase local governmental securities and remit bond issuance costs paid for with bond proceeds. The fund also collects interest and principal payments from the local governmental units and makes payments and interest on the moral obligation bonds payable.
- Fire Truck Revolving Loan Fund—The program provides zero-interest loans for the purchase of fire trucks by a fire department, a fire protection district or a township fire department based on need, as determined by the State Fire Marshal.

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- Industrial Revenue Bond Insurance Fund—This fund was established to give small and midsize businesses access to Industrial Revenue Bond funds at advantageous rates.
- Illinois Agricultural Loan Guarantee Fund—This fund was established to issue state guarantees for farmers' existing debts held by a lender.
- Illinois Farmer Agribusiness Loan Guarantee Fund—This fund accounts for the activity of the Farmer and Agri-Business Loan Guarantee Program, the Specialized Livestock Loan Guarantee Program and the Young Farmers Loan Guarantee Program. Monies held in this fund primarily serve to fund losses on uncollectible loans guaranteed under the programs.

Appendix A provides a Statement of Net Assets at June 30, 2006. Net assets stood at \$88 million in FY06 compared to \$81.1 million in FY05. The difference is primarily in loans receivable and bonds payable.

Appendix B provides a comparative summary of revenues and expenditures for the years ended June 30, 2006 and 2005. Revenues decreased from almost \$17.4 million at June 30, 2005 to \$16 million, due primarily to a reduction in State appropriations to fund the Fire Truck Revolving Loan Program. Total expenses increased from \$8.7 million at June 30, 2005 to \$9 million at June 30, 2006 primarily due to legal fees.

Appendix C provides a summary of the Authority's cash funds and depositories and investments. The Authority is permitted by statute and its investment policy to invest any of its funds in federal government securities and federal agencies, securities guaranteed by the federal government, savings accounts, certificates of deposit, savings and loans insured by the FDIC, U.S. corporations, money market mutual funds, dividend-bearing share accounts, the Illinois Treasurer's Investment Pool, a fund managed, operated and administered by a bank, repurchase agreements of government securities, obligations issued by any state, unit of local government, or school district that carry investment grade ratings. The Authority's investment policy does not address a specific type of risk exposure; however, the Authority's investment policy places the following restrictions on concentrations of investments:

- Certificates of Deposit from any single institution may not comprise more than 20% of the Authority's portfolio or 5% of the institution's total deposits.
- Commercial Paper purchases may not exceed 20% of the Authority's portfolio or 5% of the Authority's portfolio in any single issuer's name.
- No investment category shall exceed 30% of the portfolio with the exception of U.S. Treasury securities and cash equivalents, including CDs.

Total cash funds and depositories were almost \$50 million in FY06 and investments were almost \$16.9 million, compared to \$50.4 million in cash and depositories and almost \$17.3 million in investments in FY05. The Authority currently has investments, valued at about \$5.3 million, in one partnership and 17 companies. These investments were made to accomplish the statutory purpose of the Venture Investment Fund. There is no established market for the purchase or sale of the partnerships and company interests or the equity

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securities in which the partnerships have investments. Fifteen companies have zero values.

The Authority issues limited obligation revenue bonds and participates in lending and leasing agreements to provide low cost financing to businesses, agribusinesses, health care facilities, educational facilities, municipalities, and other organizations. The bonds and leases are secured by the property financed. Upon repayment of the debt, ownership of the acquired facilities transfers to the entity. As of June 30, 2006 the aggregate amount of conduit debt outstanding was approximately \$20.92 billion comprised of 803 outstanding issues. There were 67 new bond issues and loans valued at \$2.3 billion in FY05.

Appendix D summarizes the Authority's property and equipment. The value of the Authority's capital assets, net of accumulated depreciation was \$149,670 at June 30, 2006. The increase over 2005 was due primarily to the purchase of computers, software, furniture and equipment.

According to the Authority's records, 8,365 jobs were created or retained as the result of IFA direct loans and other bond programs in FY06. Unaudited data regarding the number of jobs created or retained is found in Appendix E.

The Authority has several agricultural bond and loan programs available to eligible individuals and businesses. The Authority receives a \$100 - \$300 application fee from each program plus a fee of 0.5% to 1.5% of the principal amount of the bond or loan. Appendix F provides a historical summary for currently available agricultural programs. The following is a summary of the various programs at June 30, 2006:

- Agricultural Development Bond Programs, created in 1982, is comprised of the Beginning Farmer Bond, Agriculture Manufacturing Bond and Beginning Farmer Contract Bond. Principal outstanding is \$84,734,663.
- State Guarantee Program of Restructuring Agricultural Debt was created in 1985 to consolidate and spread out the farmer's existing debt over a longer period of time at a reduced interest rate. Outstanding loans amount to \$46,709,817.
- Farmer and Agri-Business Loan Guarantee Program, created in 1985 to encourage diversification and vertical integration of Illinois agriculture, had outstanding loans which amount to \$8,158,412.
- Young Farmer Loan Guarantee Program, created in 1993 to enhance credit availability for younger farmers purchasing capital assets, had outstanding loans, which amount to \$2,623,461.
- Specialized Livestock Loan Guarantee Program, created in 1996 to encourage the development of the Illinois livestock industry, had outstanding loans, which amount to \$17,511,697.

The Fire Truck Revolving Loan Program, re-created in 2005, had outstanding loans of \$8,766,437.

Accountants' Findings and Recommendations

Condensed below are the seven findings and recommendations, two repeated, presented in the report. The following recommendations are classified on the basis of information provided in the report and updated information provided by Kym Hubbard, Executive Director, via email dated November 16, 2007.

Partially Accepted

- 1. Conform personnel practices to governing law and seek an opinion from the Attorney General to determine if the Authority is exempt from the Personnel Code. (Repeated-2005)**

Finding: The Authority paid \$289,149 in incentive compensation pay during FY06 to 25 employees based on an Incentive Based Compensation Plan that is not allowable under the Personnel Code. The Incentive Based Compensation Plan is calculated based on individual performance and the Authority's performance.

Management indicated the Authority has a legal opinion that the Illinois Finance Authority is exempt from the Personnel Code, therefore, allowing the Incentive Based Compensation Plan. Management further stated that during the current fiscal year they have used outside legal counsel to continue to research the issue and had not yet sought an opinion from the Attorney General as they had indicated they would do in response to the prior year's finding.

Response: The Authority accepts the auditor's recommendation but does not accept the finding. The Illinois Finance Authority Act, 20 ILCS 3501/801-1, exempts the Authority from the Personnel Code because it allows the Authority to establish its own system of personnel administration. The Act requires that the Authority "employ agents and employees and independent contractors necessary to carry out its purposes and fix their compensation, benefits, and terms and conditions of their employment." Under the express language of the Personnel Code, "all offices and positions of employment in the service of the State of Illinois shall be subject to the provisions of the Act unless exempted in this or any other Act." Per the requirements of the Illinois Finance Authority Act, the Authority has established a system of personnel administration and the Authority does not participate in the State's pension retirement, health care, and other State employee benefits. The Authority bases its opinion on a 2004 legal opinion which reviewed the Act, the State Personnel Code, and case studies, and concluded that the Personnel Code did not apply to the Authority, therefore allowing for its own system of personnel administration, including a performance based incentive compensation program. In accordance with the auditor's recommendations, the Authority sent a letter dated February

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Partially Accepted – concluded

08, 2007 to the Attorney General's Office regarding the applicability of the Personnel Code to the Authority. The Authority is presently waiting for a response to this letter.

Auditors' Comment: The auditors continue to believe that absent specific exemption in either the Illinois Finance Act or the Personnel Code, all positions of employment in the service of the State of Illinois are subject to the provisions of the Personnel Code (20 ILCS 415/4).

In its response letter dated April 26, 2006 to the fiscal year 2005 finding on this same issue, the Authority indicated that it would seek an opinion from the Attorney General regarding the applicability of the Personnel Code to the Authority. The letter sent February 8, 2007 referenced in the Authority's response does **not** seek such an opinion, but rather requests information from the Attorney General on the process necessary to seek an opinion.

Updated Response: Partially Accepted. Management indicated the Authority is exempt from the Personnel Code, therefore, allowing the Incentive Based Compensation Plan. This is based on a legal opinion from Mayer, Brown, Rowe and Maw issued to the Authority in 2004. It is also based on the legal opinion of Shefsky & Froelich and IFA's General Counsel. The Opinion concluded that the Personnel Code does not apply to the Authority. The IFA Act exempts the Authority from jurisdiction of the Personnel Code because it grants to the Authority the power to establish its own system of personnel administration.

The Authority submitted a letter to the Attorney General's office, dated February 8, 2007 requesting an opinion as to whether the IFA is exempt from the provisions of the Personnel Code. On November 21, 2007, the Chief of the Opinions Bureau responded that she did not believe that the AG's Office is authorized to issue an opinion in response to the Authority's request since the Authority is created as a "body politic and corporate" and has the power "to sue and be sued...and engage attorneys." The AG's Office further stated that while the Authority may not obtain an opinion from the AG, the Auditor General or the Legislative Audit Commission may request the assistance of the AG in the matter.

Implemented

2. **Continue to work with the Comptroller's Office to comply with SAMS Procedures for bond reporting requirements with the Comptroller. (Repeated-2005)**

Finding: The Authority did not report required revenue bond information to the Illinois Office of the Comptroller. During the FY06, there were 803 conduit debt bonds with a total principal balance outstanding of \$20.9 billion that were in the care of the Authority.

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According to the Comptroller's report of delinquent notices of principal and interest payments dated August 31, 2006, there were approximately 1300 delinquent notices of principal and interest payments. The Authority also receives the same notices of principal and interest payments from the bond trustees that are filed with the Comptroller. The Authority's records indicated approximately 12 delinquent notices of principal and interest payments. The auditors were unable to determine which records were accurate.

Management indicated that they have had numerous communications with the Comptroller in order to eliminate the inconsistencies between the Comptroller's reports and the Authority's reports.

Updated Response: Implemented. Management indicated that they have had numerous communications with the Comptroller regarding this issue. The Authority believes the Comptroller has many false positives, i.e. a principal or interest payment is marked delinquent but no principal or interest was due that month. In addition, the C-08 or Notice of Payment of Bond Interest and or Principal are issued by third party trustees and out of direct control of the IFA. Employee transition of the trustee staff and a buy out of Chase (IFA's original trustee) by the Bank of NY also contributed to this finding.

The Authority and the Comptrollers have discussed this issue via phone and in person. The Authority takes a proactive role in insuring the C-08's are received on time. The Authority runs a monthly report of C-08 that has not yet been received and then follows up with the responsible third party via email and phone calls. The Authority receives quarterly reports from the Comptroller in an effort to reconcile the two reports and significantly reduce the number of delinquencies on the Comptrollers reports.

3. Strengthen controls over the agricultural loan approval process.

Finding: The Authority did not have all required documents for State Guaranteed Agriculture Loans as follows:

- two of 13 State guaranteed loans totaling \$568,850 for existing farmer debt did not have a lender and borrower application on file;
- one of five State guaranteed loans totaling \$425,000 for specialized livestock did not have lender and borrower applications on file;
- one of five State guaranteed loans for specialized livestock did not pay the \$300 application fee to the Authority; and
- one of five State guaranteed loans totaling \$212,500 for specialized livestock had a loan duration of 25 years, which exceeded the statutory requirement of 15 years.

Management indicated that proper documentation procedures were not followed in file closings.

Accepted or Implemented – continued

Updated Response: Implemented. The Authority has reviewed the files noted by the auditors and agrees with the finding. The Authority has obtained the missing documents from the lenders.

The IFA staff now maintains a file checklist of each file to ensure that all documents are on file and in compliance with IFA policies. The Authority will perform periodic audits of closed files for compliance.

4. Comply with the Procurement Code and take the necessary steps to improve the timeliness of reducing contracts to writing and filing emergency purchase affidavits.

Finding: The Authority did not timely execute a contract or timely file an emergency purchase affidavit for legal services totaling \$807,470 procured under the emergency purchase exception.

Based on a review of emergency purchases procured by the Authority, the auditors noted that the Authority had one emergency purchase contract for legal services that dated from June 10, 2005 through June 9, 2006 with an actual cost totaling \$807,470. The original emergency purchase affidavit was filed on September 7, 2005 with the Office of the Auditor General, 79 days late. The emergency purchase affidavit stated that the emergency purchase of legal services was due to the unexpected resignation of its General Counsel on June 9, 2005 and the Authority estimated the total cost to be \$165,000. The law firm procured on an emergency basis began work without a contract on June 10, 2005. The Authority reduced the contract to writing on October 18, 2005, 130 days after services began.

Management stated they did not reduce the contract to writing or file the emergency purchase affidavit timely because they originally believed the legal services procured would be limited to “routine” matters all within the purview of the vendor’s role under a separate contract for “Issuer’s counsel”, but the Authority later discovered the scope of its legal services needs was much greater than they had anticipated. Agency officials stated that these are the same reasons the original cost estimate filed with the emergency purchase affidavit differed so greatly from the actual cost incurred under the contract.

Response: Accepted. The Authority will comply with the Procurement Code and take the necessary steps to improve the timeliness of reducing contracts to writing and filing emergency purchase affidavits.

Updated Response: Implemented. Authority officials stated they did not reduce the contract to writing or file the emergency purchase affidavit timely because they originally believed the legal services procured would be limited to “routine” matters all within the purview of the vendor’s role under a separate contract for “Issuer’s counsel”, but the

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Authority later discovered the scope of its legal services needs was much greater than they had anticipated. Agency officials stated that these are the same reasons the original cost estimate filed with the emergency purchase affidavit differed so greatly from the actual cost incurred under the contract.

The Authority has reviewed the steps and requirements necessary to initiate an emergency procurement contract. The Authority will adhere to the requirements if a need to initiate an emergency procurement contract materializes in the future.

5. **Redesign the travel and marketing expense reimbursement form to clearly distinguish whether the reimbursement request is for travel or for marketing expenses. Further, carefully review employee travel and marketing expense reimbursement forms for proper documentation, mathematical accuracy and duplicate payment prior to approval of the reimbursement claim. Separately track travel and marketing expenses in the general ledger.**

Finding: During detailed testing of 32 vouchers totaling \$45,128 for travel and marketing expenses, the auditor's noted the following exceptions:

- 8 vouchers totaling \$639 did not include an itemized receipt for meals, thus, claims for non-reimbursable expenses could not be determined. Auditors were unable to determine whether these reimbursement requests were for travel or for marketing expenses.
- 2 vouchers totaling \$538 were approved for reimbursement of cell phone charges. The Authority paid the entire cell phone bill including the regular monthly fee without any supporting documents for the detail calls.

During detailed testing of 30 vouchers totaling \$16,321 for marketing expenses, the auditors noted the following exceptions:

- 1 voucher for \$502 was submitted and reimbursed twice.
- 3 vouchers totaling \$1,267 were mathematically inaccurate by \$11.

The Authority processes both travel and marketing expense reimbursements on the same form and charges these expenses to the same general ledger account in the books and records of the Authority. The design of the form makes it difficult to distinguish whether the employee is seeking reimbursement for travel expenses or marketing expenses. Marketing expenses are subject to the Authority's internal policy outlining the allowable expenses reimbursable as marketing expenses. For example, some meal expenses are allowable at a slightly higher rate for business development (marketing) breakfast or luncheons.

Updated Response: Implemented. The Authority agrees with the above findings and has created a secondary form for marketing related expenses. The Authority has been recording the above items on separate general ledger accounts effective July 1,

Accepted or Implemented - concluded

2006. The Authority instituted a policy that an itemized receipt must be submitted before expenses are reimbursed.

The Authority has hired an accounting clerk to oversee the reimbursement process function and to ensure 100% compliance with the above procedures.

6. Strengthen controls over the processing of cash receipts and refunds and timely deposit receipts and refunds in accordance with statutory requirements.

Finding: The Authority did not adequately process or timely deposit cash receipts or refunds. During detailed testing, the auditors selected cash receipts and refunds and noted the following exceptions:

- five out of 25 receipts totaling \$24,464 were not deposited timely. On average, these receipts were deposited six days late by the Authority.
- five out of 25 receipts totaling \$111,877 were not date stamped. Therefore, auditors could not determine the date the Authority received the cash or if the cash was deposited timely.
- five out of 10 refunds totaling \$1,206 were not deposited timely. On average, these were deposited 7 days late by the Authority.

Management stated the late deposits and lack of a date stamp were due to administrative oversight.

Updated Response: Implemented. The Authority agrees with the above findings and now adheres to The State Officer and Employees Money Disposition Act. The Authority has implemented a “Lock Box” with our main operating bank to receive all checks directly from IFA customers/clients. In addition, any check received at the Authority will be processed “remotely” with equipment and software provided by the bank. The Authority will monitor the above process to ensure on-going compliance.

7. Review personnel files and obtain or replace any missing documents from employees’ personnel records. In addition, implement controls to ensure that the proper forms and documentation are maintained in personnel files.

Finding: The Authority’s personnel files lacked required documents. During sample testing of 33 employee files the auditors noted the following:

- two out of 33 employees had no job description included.
- one out of 33 employees had a missing Educational Loan Certification.
- one out of 33 employees did not have a properly completed Direct Deposit Authorization form. However, the employee received direct deposit of salary.

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- one out of 33 employees did not have written documentation of Director's approval for flexible working hours of 6:30 am to 4:30 pm.

Management stated that missing documents were due to oversight.

Updated Response: Implemented. The Authority agrees with the above finding. A job description has been created and filed for the IFA interns. The missing documents have been obtained and filed. The IFA HR policy 2.5 will be amended to extend the "Authority Hours" from 8-5pm to 6:30-5:00pm.

The Authority has implemented a "checklist" to ensure that all personnel files are complete. The Authorities HR Policy (2.5) was amended. IFA may approve flexible work hour for employees if doing so it will not disrupt the effectiveness of The Authority. Any employee who wishes to be placed on flexible work schedule should work out the arrangement with their supervisor or manager.

Emergency Purchases

The Illinois Purchasing Act (30 ILCS 505/1) states, "The principle of competitive bidding and economical procurement practices shall be applicable to all purchases and contracts..." The law also recognizes that there will be emergency situations when it will be impossible to conduct bidding. It provides a general exemption for emergencies "involving public health, public safety, or where immediate expenditure is necessary for repairs to State property in order to protect against further loss of or damage ... prevent or minimize serious disruption in State services, to insure the integrity of State records or to avoid lapsing or loss of federal or donated funds. The chief procurement officer may promulgate rules extending the circumstances by which a purchasing agency may make 'quick purchases', including but not limited to items available at a discount for a limited period of time."

State agencies are required to file an affidavit with the Auditor General for emergency procurements that are an exception to the competitive bidding requirements per the Illinois Purchasing Act. The affidavit is to set forth the circumstance requiring the emergency purchase. The Commission receives quarterly reports of all emergency purchases from the Office of the Auditor General. The Legislative Audit Commission is directed to review the purchases and to comment on abuses of the exemption.

During FY06, the Illinois Finance Authority filed one affidavit for an emergency purchase for legal counsel for \$807,470.00.

Headquarters Designations

The State Finance Act requires all State agencies to make semiannual headquarters reports to the Legislative Audit Commission in January and July. Each State agency is

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required to file reports of all of its officers and employees for whom official headquarters have been designated at any location other than that at which their official duties require them to spend the largest part of their working time.

The Illinois Finance Authority filed a Travel Headquarters Designation form on July 13, 2006 which indicated 13 people spent more than 50% of their work time at locations other than their official headquarters.